

Message Text

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C O N F I D E N T I A L JIDDA 5055

PASS TREASURY FOR THE SECRETARY

E.O. 11652: GDS

TAGS: EFIN, SA, US

SUBJECT: SAMA CONCERNS OVER IRS RULING

SUMMARY: SAMA IS CONCERNED OVER INTERNAL REVENUE SERVICE'S RULING ON EXEMPTION FROM US TAXES INsofar AS IT MIGHT PREJUDICE ALL INVESTMENTS BY SAMA IF A SINGLE VOLUNTARY OR INVOLUNTARY "NON-PASSIVE" INVESTMENT IS MADE. THEY ARE WILLING TO PAY TAXES ON ANY INDIVIDUAL INVESTMENT IN WHICH THEY "PARTICIPATE" IN AMANAGEMENTS BUT WISH TO CLARIFY THAT THIS WILL NOT MAKE THEM LIABLE ON ALL OTHER INVESTMENTS. THERE ARE GENERAL CONCERNS OVER DEGREE OF RISK THAT SAMA MIGHT BE DECLARED SUBJECT TO TAXES FOR POLITICAL REASONS. EMBASSY RECOMMENDS CLARIFICATION BE ISSUED THAT AN INVESTOR WHO CHOOSES OR INVOLUNTARILY MAKES WHAT IS LATER INTERPRETED AS A NON-PASSIVE INVESTMENT BE GRANTED LIMITED LIABILITY AND BE TAXED ONLY ON THAT INVESTMENT. END SUMMARY.

1. GOVERNOR ABD AL AZIZ QURAYSHI HAS FURNISHED US WITH COPY OF IRS RULING OF JUNE 26 WHICH HE DESCRIBED AS HELPFUL BUT WHICH STILL DOES NOT ENTIERELY CLARIFY THE OVERALL STATUS OF SAMA AND/OR ITS INVESTING AGENTS.

2. HIS CONCERNS WERE TWO: SUPPOSING THAT SAMA IS
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CONSIDERED A FOREIGN GOVERNMENT FOR PURPOSES OF THE

RULING AND, THEREFORE, EXEMPT UNDER SECTION 892 OF THE IR CODE, WHAT HAPPENS IF SAMA SHOULD VOLUNTARILY OR INVOLUNTARILY HAPPEN TO INVEST IN A MANNER THAT IS NOT CONSIDERED "PASSIVE"? THE GOVERNOR SAID THAT THEY WOULD BE PERFECTLY WILLING TO PAY TAXES ON ANY INVESTMENT RULED TO BE NON-PASSIVE (OR ACTIVE) IN NATURE, I.E. WHERE THEY HAVE PARTICIPATED IN MANAGEMENT. BUT DOES THIS THREATEN THEIR WHOLE STATUS FOR ALL OTHER INVESTMENTS? IS THERE A CHANCE THAT IF SAUDI POLICY SHOULD CHANGE AND SAMA IS ASKED BY THE SAG TO MAKE CERTAIN INVESTMENTS THAT MIGHT BE SUBJECT TO TAX, IT WOULD LOSE ITS STATUS ON OTHER INVESTMENTS? COULD POLITICAL CONSIDERATIONS INTRUDE IN SUCH CIRCUMSTANCES SO THAT SAMA IS DECLARED NO LONGER EXEMPT? SO FAR, HE ADDED, THERE WAS NO INTENTION TO CARRY ON ANY BUT PASSIVE INVESTMENT STRATEGIES; STOCK MIGHT BE VOTED BUT THE WOULD STAY UNDER FIVE PERCENT IN ANY ONE COMPANY AND THEY WOULD NOT PARTICIPATE IN MANAGEMENT.

3. SECOND, HE WENT ON, THERE WAS CONCERN THAT WITH LARGE EURODOLLAR HOLDINGS AND WITH MANY BANKS BEING AUTHORIZED TO MAKE THEIR INVESTMENTS, THEY MIGHT INADVERTENTLY CROSS THE LINE BY ONE OF THE BANKS MAKING AN INVESTMENT IN U.S. STOCK. EVEN PROVIDING THEY KEPT UNDER FIVE PERCENT IN TOTAL INVESTMENTS IN ANY COMPANY, THE QUESTION STILL REMAINS CAN THE OFF-SHORE INVESTING AGENT CERTIFY SAMA SUCCESSFULLY AS THE OWNER AND GAIN TAX EXEMPTION?

4. AS REPORTED ELSEWHERE, SAMA HAD ALREADY HELD UP SEVERAL INVESTMENTS IN U.S. BONDS AND STOCKS PENDING THE EXPECTED IRS RULING. SAMA HAS NOW GONE BACK TO ITS U.S. LAWYERS AND ASKED FOR FURTHER INTERPRETATIONS OF THE NEW RULING, IN PARTICULAR REASSURANCE THAT ALL TAX EXEMPT EARNINGS FROM INVESTMENTS WILL NOT BE PREJUDICED BY A SINGLE NON-PASSIVE INVESTMENT.

5. A THIRD QUESTION (WHICH QURAYSHI DID NOT RAISE WITH US) HAS BEEN POINTED OUT BY AN ADVISER: IS SAMA FOR THE PURPOSES OF SECTION 892 CONSIDERED TO BE ONLY A CONFIDENTIAL

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FOREIGN GOVERNMENT ORGANIZATION THAT IS ESSENTIALLY NOT CARRYING ON ACTIVITIES NORMALLY CARRIED ON BY CORPORATIONS IN THE U.S. SEEKING A PROFIT? DOES SAMA NEED TO SEEK A GENERAL INTERPRETATION FROM THE IRA BEFORE PROCEEDING FURTHER WITH ITS INVESTMENT PLANS?

6. EMBASSY REALIZES THE COMPLEXITY OF THE MATTER BUT PRESUMES THAT OUR ENTIRE POLICY IS BASED ON A DESIRE

TO ENCOURAGE SAUDI INVESTMENT IN THE U.S. BY EVERY
LEGAL MEANS POSSIBLE. IF THIS IS TRUE, THEN A CLARI-
FICATION DOES SEEM TO BE NEEDED CONCERNING BOTH POINTS
ONE AND TWO (PARA 2 AND 3) ABOVE. BOTH THE FEDERAL
RESERVE AND PRIVATE SAG CONSULTANTS MAY ALREADY BE
ALERTED TO SAMA CONCERNS BUT ANSWERS TO THESE QUESTIONS
ARE NEEDED AT A MONETARY POLICY-LEVEL.
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